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CORPORATION

BEFORE THE SENATE COMMITTEE ON COMMERCE, SCIENCE, AND
TRANSPORTATION

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Mr. Chairman and Members of the Committee, I am pleased to be here today to report to you on the status of the Schools and Libraries Corporation's administration of the universal service fund for schools and libraries with a particular focus upon the issues that are the subject of the General Accounting Office's investigation.

At the Chairman's request, the U.S. General Accounting Office (GAO) has been conducting an investigation of the operations of the Schools and Libraries Corporation (SLC), particularly our procedures to protect against waste, fraud, and abuse. The testimony of the GAO witness today provides highlights of that investigation and the findings to date. We at the SLC have viewed the GAO's investigation as a way to improve our operations. We have cooperated completely and been fully forthcoming with the GAO auditors. We have listened carefully to their observations and ideas.

The GAO has made four specific recommendations about our operations. We concur in those recommendations and will implement them.

BACKGROUND

As the Committee knows, the SLC was established to administer the schools and libraries universal service fund in accordance with rules promulgated by the Federal Communications Commission (FCC). Our mission is straightforward: to administer the fund efficiently and effectively so that every school and library has the opportunity to participate. We are fully accountable to the FCC for how we implement its rules and administer the universal service fund. In addition to FCC oversight, under the FCC rules, we are also subject to an annual, independent financial audit. And we see ourselves as equally accountable to the Congress and this Committee.

We apply three central principles to our operations:
provide high-level customer service and extensive outreach to ensure that the universal service fund is truly universally available,
provide for program integrity so that all available funds are used by eligible entities for eligible purposes at the appropriate discount level, and

- minimize administrative costs so as to maximize funds available for the discounts on telecommunications services for schools and libraries.

The staff at the SLC has benefited from the active involvement and oversight of a Board of Directors that is experienced, knowledgeable, and committed. The Board brings expertise in education, library services, and telecommunications as well as management and finance. The Board meets at least quarterly in public session.

ORGANIZATIONAL STRUCTURE

While we have substantial and important operations to administer, the Board decided early on that the SLC should not be a large organization – that we should outsource most of the day-to-day administration of the universal service fund. It is clear that the workload will vary. This first year of implementation has been very challenging – likely the most challenging, extensive, and intensive we will ever face – as we have built the SLC Web Site, established a client service bureau and a program integrity assurance program, developed operating policies and procedures, and implemented an extensive outreach program. Moreover, in 1998, we will administer more than one complete application cycle – the complete application and commitment process for the first funding year – through June 30, 1999 – and a great deal of the full annual process for the funding year that will begin July 1, 1999.

The Schools and Libraries Corporation itself has only 15 employees. The bulk of the SLC's day-to-day operations are conducted by contractors – primarily by the National Exchange Carrier Association (NECA). Development of the Web Site has been largely the work of Spectrum, Inc., and the Client Service Bureau is operated by National Computer Systems, Inc. (NCS). Both Spectrum and NCS are subcontractors to NECA. As the work load varies, these contractors adjust the staffing they have committed to the operations, and the costs vary accordingly. In future years, with startup costs behind us, we anticipate administrative costs will decline accordingly.

As you know, the boards of the Universal Service Administrative Company, the Rural Health Care Corporation (RHCC), and the SLC have recommended to the FCC a restructuring of the three organizations. That plan would merge the RHCC and the SLC into USAC as operating divisions (along with the existing High Cost/Low Income function already part of USAC). The SLC Board and its staff support the proposed reorganization. We are confident that, whether that plan or some other is ultimately implemented, administration of the schools and libraries fund will continue to be by a lean organization sized to provide management and oversight, not permanent, labor-intensive operations.

PROGRAM INTEGRITY

A. SLC Commitment to Preventing Waste, Fraud and Abuse

We share the Committee's commitment to ensuring that the resources available for the universal service fund for schools and libraries go, to the maximum extent possible, to eligible entities for eligible services and that schools and libraries receive the discounts to which they are entitled but no more. Our organizational structure and budget projection include a program integrity assurance function designed to:

put in place internal accounting and administrative controls and review procedures to provide assurance that our applications and funding commitments are in compliance with the letter and the spirit of the Telecommunications Act of 1996 and the FCC's Universal Service Order;

provide cost-effective assurance of the accuracy and qualification of data submitted by schools and libraries for universal service support;

provide cost-effective assurance of the accuracy of data and service information submitted by service providers seeking payments for the discounted cost of equipment and services provided to schools and libraries; and

protect the funds that flow into the universal service fund from fraud, abuse, waste, and misadministration on behalf of all participants.

It is, of course, our efforts to guard against waste, fraud and abuse that are the primary subject of the GAO's investigation.

As we have pointed out to this Committee in the past, one of the reasons the original budget estimate for the SLC put forward by NECA last October was incorrect is the SLC's insistence on assuring program integrity. The October budget estimate included no specific funding for program integrity assurance, for an outside, independent review of the internal controls, nor for building program integrity screens into our Web Site. At least 35 percent of our current budget projection is for program integrity assurance.

Indeed, our commitment to program integrity is evidenced from the outset of our operations not only by our investment in our operations but in our communications to schools and libraries. The first letter we wrote in November 1997 to potential participants made it clear that guarding against waste, fraud and abuse is one of our primary responsibilities. It is a warning that has been repeated consistently since then.

For example, on March 18, I posted on the SLC Web Site a letter to school, library and communications industry leaders (Attachment A) emphasizing the importance of assuring program integrity and outlining the steps we would follow to achieve that assurance. The letter was also e-mailed and faxed to all state education technology offices and all state librarians to assure maximum awareness of our program integrity policies. In the letter, I made the point that "We will be reviewing the Forms 471 very carefully to be sure that applicants comply with those rules. We will be asking applicants for supporting documentation in many cases. We will not authorize inappropriate discount rates, and will deny funding requests for discounts for ineligible services, entities, or uses."

On April 22, we added to our Web Site a "Fact Sheet on Program Integrity Assurance: What Will We Be Looking For?" (Attachment B) that describes the kind of documentation applicants may be asked to produce to support their Forms 471.

The SLC had heard reports that some schools were requesting free services as a condition for awarding contracts. We acted immediately. On March 27, 1998, the SLC posted on its Web Site and disseminated by e-mail a "Free Service Advisory."

At the same time, I also wrote directly to the superintendents of the school districts involved (Attachment C is a sample letter) making the point that "If your District awards bids for E-Rate eligible services based on the prices of eligible services <u>and</u> the value of additional, ineligible no-cost items offered by the bidder, the bid would not be in compliance with program rules. Further, such an approach to bidding may inspire bidders to attempt to recoup the value of these 'no-cost,' non-E-Rate eligible items through increased prices for E-Rate eligible services."

A number of the applicants to whom I wrote contacted us after receiving my letters to express their concern that they might not be in compliance with program rules and to assure us that they were dropping this provision of the RFPs. We, of course, have identified these applications so that the Program Integrity Assurance team will examine the terms of the contracts they have signed.

Indeed, on more than one occasion, I have been accused by applicants of being a "policeman" who did not give schools and libraries sufficient credit for being honest and trustworthy. It is the sort of accusation of which I do not mind being on the receiving end. After all, applicants are subject to civil and criminal penalties for violating the certifications they make when applying for discounts.

B. FCC Rules Designed to Prevent Waste, Fraud and Abuse

The FCC designed the schools and libraries universal service program with a number of features specifically intended to guard against waste, fraud and abuse. The program combines market-driven incentives with direct regulatory sanctions.

There are two critical market-driven protections. First, the FCC required posting on the SLC Web Site of new service requests to encourage competitive bidding and the lowest prices. Applicants must in turn comply with state and local competitive bidding rules. Service providers have demonstrated that they are monitoring contracts awarded to be sure that they are not disadvantaged by applicants not complying with FCC rules. Moreover, the very nature of competitive bidding guards against wasteful pricing and costs. Second, the schools and libraries must pay from their own budgets the non-discounted portion of the services for which they are seeking discounts. Overbuying or wasteful expenditures are therefore discouraged because the schools and libraries also would be "wasting" their own limited budgets, which themselves are under the scrutiny of local or state authorities and community leaders.

Supplementing these market-based protections are a number of direct regulatory requirements. First, the FCC required certification, under penalty of civil and criminal enforcement, that the applicant is complying with program rules. Critically, as it relates to the issue of "gold plating," the certification includes the requirement that the schools and libraries "have secured access to all of the resources, including computers, training, software, maintenance, and electrical connections necessary to make effective use of the services purchased as well as to pay the discounted charges for eligible services." In addition, the FCC required that schools and libraries receiving discounts have approved technology plans that include an assessment of how the requested services will contribute to goals for improvement of education or library services, a plan for staff development, and a sufficient budget to maintain and effectively use the new services and equipment.

C. SLC Program Integrity Measures and Operations

The SLC program integrity measures represent another set of overlapping protections against waste, fraud, and abuse.

Our Web Site automatically checks application data entered on-line to ensure that all the necessary data are entered and are in the appropriate format. In fact, a result of that has been to slow the entry of data from the Forms 471, which were all submitted on paper. If applicants failed to complete required fields or included information that was inappropriate for a particular field (e.g., words in a date field), those entries must be corrected before the application can be completely entered on-line.

More sophisticated analysis of the applications will occur as part of the program integrity process. Detailed procedures have been written, combining automated and manual review of the Forms 471, to verify that discounts are requested for eligible services to be provided to eligible entities at the appropriate discount rate and that applicants are complying with other aspects of the FCC program rules.

Our computer system will flag applications that raise potential issues of program compliance. Different flags are used to target the risks that we are guarding against. High unit costs for services and equipment, for example, will lead us to review applications and supporting documentation for ineligible services included in the request for discounts or equipment. As we examine these applications, we will review RFPs, contracts, etc., to determine that vendors' offers of "no cost" ineligible items were not a basis of a decision to award a contract. In appropriate cases, we will ask for technology plans and budgets to check that the schools and libraries receiving services and equipment have adequate resources to support the new services and equipment and pay for the undiscounted share of their funding request.

In addition to reviewing applications flagged by the system as potentially raising program compliance issues, we will conduct reviews of a risk-based sample of applications even though they are not flagged as raising such issues. These reviews will include assessments of the adequacy of the applicant's resources to support the services for which it is requesting discounts, to assure the validity of the applicant's certification on this issue.

NECA has hired and trained a stable, experienced staff to perform the numerous reviews at the pre-commitment stage and at various points after funding commitment; in addition, as part of peak-load management, accounting professionals hired on a temporary basis are being used to assist in the process.

In short, from day one, we have invested a great deal of energy, thought, time and budget resources in designing and implementing a thorough program integrity assurance system. We are committed to a cost-effective, comprehensive system to guard against waste, fraud, and abuse.

INDEPENDENT ASSESSMENTS OF SLC INTERNAL CONTROLS

We have not relied solely upon our own abilities in this area. As the FCC required, we have underway an independent assessment of controls by Coopers and Lybrand – now Pricewaterhouse Coopers – an independent accounting firm. They are providing valuable advice to us as we finalize the program integrity assurance process.

And program integrity is, of course, the primary focus of GAO's investigation of the SLC. We have provided to GAO staff a great deal of material, including our Program Integrity Assurance procedures. The GAO has interviewed our staff, NECA staff, and visited and observed the program integrity operations at NECA.

We have listened very carefully to GAO during the course of this investigation. On June 23, after receiving an oral briefing on the information they had gathered up to that date, I wrote to GAO (Attachment D) to identify steps we were taking in response to questions and issues they had raised. They had concerns about whether our tests for ineligible services were rigorous enough; we tightened them and promised to review a sample of applications our processes suggest are free of ineligible services to find out if our processes are missing any such services. They raised questions about our method for validating that applicants are seeking the appropriate discount rates; we have and will continue to test our hypothesis in this area as well. They expressed concern about whether we would truly be ready to make funding commitments when we took that action. I spelled out a series of conditions we will have to meet before we issue funding commitments.

As they finalized their testimony for this hearing, GAO developed specific recommendations for changes in our program integrity assurance procedures. We have agreed to implement those recommendations.

UNIVERSAL PARTICIPATION AND COMPETITIVE BIDDING

Universal Participation

One of our first responsibilities was to establish a system and set of activities to ensure that every school and library – no matter where located or how poor – could participate in

the universal service fund if it chose to do so. There are approximately 126,000 eligible public and private schools and libraries. When we started, there were widely varying levels of awareness about, and understanding of, the universal service fund.

During the week of December 8th, we mailed approximately 40,000 packages of applications and program descriptions to school districts, library systems, and private schools across the country to familiarize them with the universal service fund and to help get them started gathering the information they need to complete the application forms. At the same time, we opened our Client Service Bureau. Through a toll-free number, e-mail system, and fax system, schools, libraries, and service vendors are able to ask whatever questions they may have and promptly receive the answers they need. The Client Service Bureau also provides hands-on assistance in filling out the applications for participation in the fund.

Our budget estimates had assumed 51,400 calls during 1998 at 7 minutes each with a 95 percent live answer objective and 4,300 faxed inquiries. To date, the Client Service Bureau has received over 90,000 inbound calls, more than 10,000 e-mail requests, and more than 2,200 fax queries.

Staff of the SLC have participated − by phone, video link, or in person − at some 136 training and technical assistance sessions all around the country, conducted by national, state, regional, and local school, library, and service vendor groups, reaching audiences in big cities and remote rural areas. Several Governors and Members of Congress also have organized training sessions.

We regularly send out updated guidance to applicants. Moreover, we post information, questions and answers, and fact sheets to our Web Site. We have communicated through faxes to applicants who lacked an e-mail address to reach clients who appeared to have no Internet access. Our goal is to enable every school and library in the country regardless of how small or remotely located to participate if it so chooses. We continue to look for new ways to accomplish this and welcome any suggestions that members of the Committee have.

We also have taken prompt and coordinated action to assure that religious, private, and independent schools are able to participate as soon as possible. As the Committee is aware, in order to receive discounts, schools and libraries must have approved technology plans. The SLC has the responsibility for establishing a technology plan approval process for those private and independent schools that are not able to receive approvals from state education agencies. In January, we issued the procedures for the approval process and have worked regularly and closely with those schools to implement these procedures.

B. Web Site and Competitive Bidding

Phone: 1-888-203-8100, Fax: 1-888-276-8736, E-mail address: question@slcfund.org

Two key tenets of the universal service fund, as established by the FCC, are local decision making and competitive bidding. Schools and libraries make their own decisions about whether and how to participate. They decide on their own what services to purchase. Once they make that decision, they post their service requests to the SLC Web Site so that service vendors from across the country have the opportunity to bid. This system has twin advantages: the schools and libraries can receive the most cost-effective services, and competition in the telecommunications market is encouraged.

The SLC, through its contractors, has constructed a Web Site (www.slcfund.org) that accommodates the wide range of choices that schools and libraries are making. It also enables service vendors to search for bidding opportunities. Service providers interested in bidding to provide services can view the applications on-line or receive electronic summaries of requests for service by state. We encourage members of the Committee to visit the Web Site to get a first-hand impression of the range of participation among interested schools and libraries.

On January 30, 1998, we opened our Web Site for schools and libraries to begin the process for applying for discounts. Even in this first year, it is clear that the statutory goal of universality is well on its way toward being met. As of April 15, 1998, the end of the 75-day window during which all applications are to be treated as if simultaneously received, we had received more than 30,000 FCC Forms 471 requesting discounts.

We have received applications from schools and libraries in all 50 states. Particularly heartening is that participation has come from urban and rural, big and small, rich and poor, public and private.

Based on a statistically valid sample of the Forms 471 received, we have projected that the requests for discounts will total $2.02 billion and that 53 percent of that total is for the most disadvantaged schools and libraries – those qualifying for discounts of from 80 to 90 percent. And many of the applications are for modest amounts: we estimate that 53 percent of the Forms 471 are requesting less than $10,000; and 14 percent, less than $1,000.

CONCLUSION

Universal service for schools and libraries is off to a strong start. The overwhelming response to the opening of the Web Site is concrete evidence of the need schools and libraries have for access to the Information Age. SLC will continue to work diligently to ensure that the fund is administered properly and efficiently. In particular, we will aggressively implement the procedures we have in place to ensure that discounts go only to eligible entities for eligible services at the appropriate discount percentage and that other program rules reflected in the certifications an applicant must make on the application forms are observed. There is, of course, no way to prevent or detect all

abuses, but we believe that we have put in place a system that, in conjunction with the incentives built into the FCC's rules, is thorough, sound, and practical.

SLC fully recognizes that it has a substantial responsibility and accountability to Congress, this Committee, and the FCC. By focusing exclusively upon the most effective and efficient administration of the universal service fund for schools and libraries, SLC is confident that it can successfully discharge that responsibility.

I would be pleased to answer any questions you may have about our implementation of the universal service fund for schools and libraries.

Attachments